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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1960

No. 151

JOHN T. JARECKI, former Collector of Internal Revenue, et al.,

Petitioners,

vs.

G. D. SEARLE & CO.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF FOR RESPONDENT

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BRIEF FOR RESPONDENT

Opinions Below

The opinion of the district court (R. 41-45) has not been officially reported. The opinion of the court of appeals (R. 49-53) is reported in 274 F. 2d 129.

Jurisdiction

The judgment of the court of appeals was entered on January 27, 1960 (R. 54). The petition for a writ of certiorari was granted on October 10, 1960 (R. 57). The jurisdiction of this Court was invoked under 28 U.S.C. 1254(1).

Question Presented

Is respondent entitled to a trial on the merits of its suit for refund of excess profits tax under the provisions of Section 456 of the Korean War Excess Profits Tax Act, granting relief for abnormal income? Respondent asserts that income resulting from its discovery of two breakthrough drugs effecting completely new treatments for illness qualifies for relief under this statute.

Statute and Regulations Involved

Section 456 of the Excess Profits Tax Act of 1950, which is no longer in effect (see 67 Stat. 175), provided in pertinent part (64 Stat. 1137, 1186; Section 456 of the Internal Revenue Code of 1939, 26 U.S.C. 1952 ed., § 456):

"SEC. 456. *Abnormalities in income in taxable period.*

"(a) *Definitions.*—For the purposes of this section—

"(1) *Abnormal income.*—The term 'abnormal income' means income of any class described in paragraph (2) includible in the gross income of the taxpayer for any taxable year under this subchapter if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess of 115 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence.

"(2) *Separate classes of income.*—Each of the following subparagraphs shall be held to describe a separate class of income:

"(A) Income arising out of a claim, award,

judgment, or decree, or interest on any of the foregoing; or

"(B) Income resulting from exploration, discovery, or prospecting, or any combination of the foregoing, extending over a period of more than 12 months; or

"(C) Income from the sale of patents, formulae, or processes, or any combination of the foregoing, developed over a period of more than 12 months; or

"(D) Income includible in gross income for the taxable year rather than for a different taxable year by reason of a change in the taxpayer's method of accounting.

All the income which is classifiable in more than one of such subparagraphs shall be classified under the one which the taxpayer irrevocably elects. The classification of income of any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary."

* * * *

Section 40.456-2(b) of Treasury Regulations 130 (as amended by Treasury Decision 6026 of July 3, 1953; 1953-2 Cum. Bull., p. 235) provides as follows:

"Other income, not within a class described in subparagraphs (A)-(D) of section 456(a)(2), to which section 456 is applicable may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of section 456(a)(2) as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in the light of the taxpayer's business experience and accounting practice. Income from the sale of tangible property arising out of research and development which extended over a period of more than 12 months is not included in the list of abnormal types of

income to which section 456 is applicable, and such income may not constitute a class of income for purposes of that section. However, section 456 is applicable to such income if the income is otherwise properly includible within a class of income to which such section is applicable, for example, the class described in section 456(a)(2)(D)."

Statement

Contrary to statements in the petitioners' brief (Br. 2, note 1; Br. 9), the facts are in dispute.[1] Many crucial facts are contested (p. 5 of March 31, 1959 transcript; see R. 47). However, certain other facts are established by the record. Respondent G. D. Searle & Co., a pharmaceutical company, seeks to recover part of the excess profits taxes paid for the years 1950 through 1952 on income resulting from its discovery of two drugs, Banthine and Dramamine (R. 3-15). Summary judgment was entered against respondent (R. 45) despite its insistence that factual issues are involved and evidence required to support its claim.

This proceeding involves respondent's right to tax relief under the Korean War Excess Profits Tax Act for income resulting from discovery of two drugs, Banthine and Dramamine. This Act permits special treatment of income resulting from discovery if the income falls within a class of "abnormal income" specified by the Act. If part of such "abnormal income" is attributable to other years, the statute mitigates in some degree the full excess profits tax impact.

One of the district court's orders in this proceeding lim-

1. The petitioners refused to join in a typical stipulation of facts. The scanty stipulation that was executed (R. 24-25) was merely intended to shorten the trial and was "subject to the right of either party to introduce * * * further evidence" at the trial (R. 24-25).

ited the substantive issue to the determination of the character or class of respondent's income from these discoveries. Other issues raised by the requirements of the Act, such as the computation of the amount of abnormal income and the years of attribution, have all been held in abeyance. (R. 25.)

Respondent appealed from a summary judgment rendered for petitioners by the district court (R. 45). The district court held that respondent's drugs were "products arising out of research and development and as such specifically prohibited by Congress from being considered discoveries within the meaning of Section 456(a)(2)(B)" (R. 43-44). Respondent also contended in the alternative that even if its income from the discoveries of Dramamine and Banthine was not the result of "discovery" within the meaning of Section 456(a)(2)(B), it constituted a separate class of abnormal income granted relief under the last sentence of Section 456(a)(2) (R. 43). The district court held, however, that "income from the sale of tangible property arising out of research and development may not be classified as abnormal" under any theory (R. 44).

Since this case arose on appeal from a summary judgment, the record contains few of the facts which respondent intended to establish at the trial. Dramamine is a new drug for the relief of motion sickness and Banthine a new drug for the treatment of peptic ulcers. Respondent advised the district court of its intent to prove that both Dramamine and Banthine were break-through discoveries involving new compositions of matter, and that their effect on the body constituted an unprecedented approach to the treatment of motion sickness and peptic ulcers (see Transcripts of both district court hearings, R. 47). Contemporary medical literature and other publications termed these two drugs *discoveries*, for, unlike all of respondent's other products,

including Pavatrine (cf. Govt. Br. 3, note 4), they were not improvements on existing drugs (cf. R. 3, 29-38). Their large sales and widespread imitations were further indicia that these drugs were genuine discoveries.

In the alternative, respondent intended to prove at the trial that it was "reasonable" and "appropriate" within the meaning of the applicable Treasury Regulations to treat the income from Dramamine and Banthine as abnormal under the last sentence of Section 456(a)(2) even if it did not qualify as "discovery" income under Section 456(a)(2)(B), since these drugs were utterly dissimilar from any of respondent's other products (see R. 3).

Respondent's income and excess profits tax payments during the three years in question totaled $9,093,230.47 (R. 16-18). Of this amount, the complaint sought to recover approximately $3,600,000 under the abnormal income provisions of the Korean War Excess Profits Tax Act (R. 41).

The court of appeals held that "discovery" in Section 456(a)(2)(B) of the 1950 Act (*supra*, p. 3) was not confined to natural resources. Concluding that factual issues were presented, the court reversed the summary judgment and held that respondent should be permitted to prove whether Dramamine and Banthine are actually discoveries (R. 53). The judgment of the court of appeals did not determine that respondent is entitled to recover any particular amount: only that respondent be given an opportunity to prove its case. The judgment leaves to the trial court all questions of determination of existence of abnormal income, including the complicated statutory computation of amount (see R. 4-6, 25).

SUMMARY OF ARGUMENT

I.

Section 456(a)(2)(B) of the 1950 Korean War Excess Profits Tax Act accords some relief to abnormal income resulting from a "discovery". That term is not confined to natural resources but is commonly applied to new drugs such as are involved here. *Smith, Kline & French Laboratories* v. *Clark & Clark*, 157 F. 2d 725, 729 (C.A.3, 1946), certiorari denied, 329 U. S. 796; *Wisconsin Alumni Research Foundation* v. *George A. Breon & Co.*, 85 F. 2d 166, 167, 171 (C.A.8, 1936); Webster's New International Dictionary (Unabridged 2d ed.) p. 745. In fact, at the hearings on the Korean War Excess Profits Tax Act, certain new drugs were described as discoveries. Hearings before the Senate Finance Committee on H. R. 9827, 81st Cong., 2nd Sess. (1950) p. 709. Because the word "discovery" as generally used encompasses the discovery of new drugs, summary judgment was improper.

II.

Since Congress did not indicate otherwise, the term "discovery" must be given its ordinary meaning. *Avery* v. *Commissioner*, 292 U. S. 210, 214. Where Congress has intended to confine tax statutes to mineral deposits, it has so specified. The fact that "discovery" is used in a narrow sense in certain other statutes with different purposes, where a restrictive interpretation is expressly indicated, does not require the adoption of a similar narrow meaning in Section 456 where no limitation on the term was stated or intended. *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84; *Wong Kam Wo* v. *Dulles*, 236 F. 2d 622 (C.A.9, 1956). Petitioners' citations of examples of Congress' generous tax treatment of the natural resources industries are

beside the point. Unlike the provisions on which petitioners rely, neither Section 456 nor its precursor contained any language in text or heading which showed it was confined to the field of natural resources.

The aim of Congress to grant relief under Section 456 to abnormal income attributable in part to prior years would be frustrated by holding that "discovery" must be limited by the words "exploration" and "prospecting" in subparagraph (a)(2)(B). The maxim *noscitur a sociis* is not applied to limit the plain meaning of a word or where contrary to the statutory purpose. *Russell Co.* v. *United States*, 261 U. S. 514; *Helvering* v. *Stockholms Enskilda Bank*, 293 U. S. 84. Section 721 of the World War II Act, the predecessor of Section 456, was not limited to mining operations even though the same combination of exploration, prospecting and discovery was used along with other words. Section 456 was ultimately derived from Section 327(d) of the Revenue Act of 1918, under which relief was not restricted to oil, coal and gas.

The legislative history of Section 456 and its predecessors does not show that "discovery" was confined to natural resources. Although petitioners rely on the elimination of the words "research and development" during the enactment of Section 456, an amendment to the Treasury Regulations shows that Section 456 applies to discoveries, whether or not they occur from research and development. As shown by the history of other tax statutes, Congress would have used express language if it had meant to confine Section 456 discovery relief to natural resources. Neither the Committee Reports relating to the 1940 predecessor Section 721 nor the reports and Congressional debates on Section 456 show any intention to confine relief to the extractive industries. Instead, both statutory provisions were considered to have "general application".

The fact that patents are listed in Section 456(a)(2)(C) does not mean that patentable discoveries are not within Section 456(a)(2)(B), for the statute itself acknowledges that income might be "classifiable in more than one of such subparagraphs". Cf. *Securities & Exchange Commission* v. *C. M. Joiner Corp.*, 320 U. S. 344.

III.

The main objective of the Korean War Excess Profits Tax Act was to tap profits swollen by those hostilities. However, Section 456 was enacted to provide relief where profits were not attributable to the wartime economy. In providing that Section, Congress recognized the unfairness of bunching for heavy taxation in one year income which is attributable to several years. Accordingly, consistently with the purpose of Section 456, respondent should be permitted to prove at trial what portion of its income was attributable to its discovery of Dramamine and Banthine.

IV.

In the alternative, respondent's income from Dramamine and Banthine constituted a special class of abnormal income under the last sentence of Section 456(a)(2) and the regulation. Instead of being precluded by summary judgment, respondent should be given an opportunity to show that it was reasonable and appropriate to treat the income from these break-through drugs as a separate class of abnormal income within the purview of those provisions.

ARGUMENT

I. THE ORDINARY MEANING OF THE WORD DISCOVERY INCLUDES THE DISCOVERY OF NEW DRUGS.

The Government claimed in earlier stages of this litigation that the common meaning of "discovery" is limited to the finding of something already in existence, *i.e.*, the uncovering of mineral deposits. Although this argument does not seem to be seriously advanced here (Br. 5), respondent will show that the term discovery, in everyday parlance, includes the discovery of new drugs as well as coal, oil, gas, and so forth.

The word "discovery" has been applied to new chemical compounds of medical value in more than one judicial opinion. For example, in *Smith, Kline & French Laboratories* v. *Clark & Clark*, 157 F. 2d 725 (C.A. 3, 1946), certiorari denied, 329 U.S. 796, the court was considering a certain salt called amphetamine sulphate, a novel compound which was allegedly of great importance in the treatment of various diseases. The court noted that the inventor Alles was attempting "to find a useful drug for treating allergic diseases whereby he *discovered* amphetamine sulphate, . . . That Alles' contribution was of great therapeutic use and value may not be doubted. Following his *discovery*, physicians had at hand a drug which could affect, even create, mood. Alles' *discovery* is close to pioneer invention."[2] 157 F. 2d at p. 729.

Another similar instance of the use of the term "discovery" in its ordinary sense may be found in *Wisconsin Alumni Research Foundation* v. *George A. Breon & Co.*, 85 F. 2d 166 (C.A. 8, 1936), in which the court applied the following language to a vital new drug (at pp. 167, 171):

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2. Emphasis throughout this brief is added unless otherwise indicated.

"The valuable feature of the *discovery*, and the thing that is claimed to be new and novel, consists in the combined or coacting use of the salts of copper and iron to build up the hemoglobin content of the blood.

• • • • •

"It never occurred to any of the authors of the publications in evidence that the remedy for which they were in search, namely, to increase the hemoglobin count, was to be found in some combination of inorganic iron (not alimentary) and copper in definite proportions. How, then, could their writings anticipate such a *discovery* made many years later?"

The usual or common meaning of discovery is also revealed by a newspaper editorial[3] commenting on the Kefauver Committee's investigation of the price of drugs. The editor referred to contributions by the pharmaceutical manufacturers "of great importance to the *discovery* of new remedies."

". . . This year the drug industry is laying out 200 million dollars in the hope that from this large expenditure in the laboratories some useful *discoveries* will come.

"There is no guarantee that any return will be reaped and no certainty that if something is *discovered*, some better remedy will not replace it long before the original cost is recovered."

The editorial next quotes from a speech by the president of one of respondent's competitors:

". . . I challenge soviet communism to do a better job than United States capitalism of *discovering*, developing, producing, and distributing new and effective drugs to alleviate the diseases that plague mankind.

• • • • •

3. Chicago Tribune, December 10, 1959, p. 24, col. 1.

> "In the 42 years since their October Revolution, soviet science and technology have been unable to come up with a single major drug *discovery*. . . ."

In contrast, the editorial stated that men in the free world had been able "to *discover*, to produce and to use new weapons of life for the common good of mankind." Throughout the Kefauver Committee hearings themselves, break-through drugs were also termed discoveries.

The dictionary definition of "discovery" is not limited to the discovery of natural resources whose existence and utility are already known. Webster gives as the first meaning of discovery the "finding out or ascertaining something previously unknown or unrecognized; as Curie's *discovery* of radium" (New International Dictionary [Unabridged 2d ed.] p. 745; emphasis in original). When Congress was considering the Korean War Excess Profits Tax Act, which is the statute involved here, certain drugs responsible for radical changes in the field of medicine were described at the hearing as discoveries. "The *discovery* or development of another aureomycin or another ACTH or of a cure for cancer during the taxable year must be encouraged and not penalized." Hearings before the Senate Finance Committee on H. R. 9827, 81st Cong., 2d Sess. (1950), p. 709. Similarly Dr. Hans Selye, the noted physician and professor of medicine, has written of the "discovery" of penicillin and insulin.[4] And as respondent's proposed evidence at the trial would show, contemporary newspaper articles and medical literature described both Dramamine and Banthine as "discoveries".

For the sake of brevity, just one more example of the ordinary understanding of discovery will be cited. A recent

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4. Selye, "What Makes Basic Research Basic?", *Saturday Evening Post*, January 24, 1959, pp. 30, 79-80.

article in a popular magazine notes that "the setting of our lives is being changed by *discoveries* in medicine." The author complains that "most people never see science as it is practiced. They never see the pains, the care, the patience, the bewilderment, the long hours. . . . Most people see nothing but the finished *discovery*, dispassionate and neutral." The author also comments: "If we ask a scientist to decide himself whether to withhold or to disclose a *discovery* we are asking him to flout the rights of the community."[5] Obviously this usage of discovery has nothing to do with the discovery of an oil well or the like.

The question whether or not respondent's drugs, Dramamine and Banthine, were discoveries within the commonly accepted meaning of the word is a factual issue not before this Court, since this case involves only the propriety of the summary judgment granted to petitioners by the district court. The foregoing discussion demonstrates, however, that the word discovery, as generally used, does encompass the discovery of new drugs and therefore summary judgment was improper.

II. THE WORD DISCOVERY SHOULD BE GIVEN ITS ORDINARY MEANING.

A. If Congress Had Intended to Give a Special Meaning to Discovery It Would Have So Specified.

In the absence of clear indications of contrary intent, words in statutes must be given their ordinary meaning. In *United States Gypsum Co.* v. *United States*, 253 F.2d 738 (C.A. 7, 1958), acq. Rev. Rul. 58-593, the Government contended that the word "stone" in the Internal Revenue Code of 1939 was intended "to denote a particular and limited class of materials which are customarily used in the

5. Bronowski, "A Moral for an Age of Plenty," *Saturday Evening Post*, November 12, 1960, pp. 24-25.

construction industry for their physical properties, and commonly designated 'stone' by persons in that industry" (p. 741). The court of appeals rejected the argument and held that stone must be given its normal broad meaning:

> "It is well established that in interpreting the meaning to be given words used in legislative enactments the words are to be given their known and ordinary signification. The obvious, plain and rational meaning is preferable to a narrow, strained, or hidden meaning." (253 F.2d at p. 744.)

Similarly, in *Quartzite Stone Co.*, 30 T.C. 511 (1958), affirmed, 273 F.2d 738 (C.A. 10, 1959), the Commissioner contended that a mineral was not quartzite within the 15% depletion allowance provisions of the Internal Revenue Code unless it was of sufficient purity to be used as a refractory material. In rejecting this contention the Tax Court said:

> ". . . Since Congress did not see fit to place any restrictions on the term 'quartzite,' it is necessary for us to determine only whether or not petitioner's deposits are quartzite within the commonly understood commercial meaning of the term." (30 T.C. at p. 516.)[6]

In *Avery* v. *Commissioner*, 292 U.S. 210, this Court held that the "ordinary meaning" of a word used in the Revenue Acts of 1924 and 1928 was controlling, because "unless Congress has definitely indicated an intention that the words should be construed otherwise, we must apply them according to their usual acceptation." 292 U.S. at p. 214. *United States* v. *Merchants National Bank*, 261 F.2d 570 (C.A. 5, 1958), a case involving a provision of the estate tax in the Internal Revenue Code of 1939, also applied the

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6. See also *South Jersey Sand Co.* v. *Commissioner*, 267 F.2d 591 (C.A. 3, 1959); *Blue Ridge Stone Corporation* v. *United States*, 170 F. Supp. 569, 572, 573 (W.D.Va., 1959).

principle that "words should, as a rule, be given their ordinary and normal meaning." And in *Commissioner v. Marshall's Estate,* 203 F.2d 534, 537 (C.A.3, 1953), the court held, in construing another provision of the 1939 Code, that "words used in a statute must be considered to have been used by Congress in consonance with the common acceptance of the meaning of such words."

The reason for this rule is that if any special limitations on the meaning of a word were intended, Congress would have expressly so provided. As noted by the court of appeals in affirming the *Quartzite* decision, *supra,* p. 14, "had Congress intended to limit quartzite by quality, a more restricted term would have been used in describing the mineral." 273 F.2d at p. 739.

So here, if Congress had intended to limit the normal meaning of "discovery" it would have restricted the term specifically. Since it failed to do so, the word must be given its commonly understood meaning rather than the peculiar, limited meaning suggested by the Government. Certainly Congress was aware of the common meaning of the word "discovery" discussed above; and if it had felt that "discovery" of minerals was more deserving of relief legislation than a "discovery" of vital importance to the health of millions of individuals, it would have so stated.

B. Neither the Context Nor the History of Section 456(a)(2)(B) Indicates That Discovery Should Be Given a Special, Restricted Meaning.

1. *The use of "discovery" in other statutes does not show that it applies only to natural resources here.* None of the reasons advanced by petitioners for restricting the ordinary meaning of discovery in Section 456(a)(2)(B) of the Korean War Excess Profits Tax Act is persuasive. First, the Government argues that because discovery is

used with reference only to natural resources in certain other statutory provisions; the word should be similarly limited here. This argument is based chiefly on two examples, Section 105 and Section 114(b)(2) of the Internal Revenue Code of 1939 and the predecessors of those Sections in earlier revenue acts[7] (Br. 18-37, 54). Section 105 imposed a ceiling on the tax on sales of oil or gas property the value of which was demonstrated by "discovery" work by the taxpayer. This provision expressly refers to "a sale of any *oil or gas property.*" Similarly Section 114(b)(2) stated that "in the case of *mines* . . . discovered by the taxpayer" the basis for depletion should be the value at the date of discovery. In both instances Congress made it clear that the term discovery meant only the discovery of mineral deposits by adding such words as "oil or gas" or "mines." No such limitations are contained in Section 456. It is also highly significant that unlike the headings of the statutory provisions on which petitioners rely (Br. 1a, 5a, 6a, 7a, 21a, 22a, 23a, 32a, 44a), neither Section 456 nor Section 721, its 1940 precursor, contains any heading showing that their applicability was confined to the natural resources industries (see Govt. Br. 24a-28a, 37a-40a). For these reasons, petitioners' extensive treatment of Sections 105 and 114(b)(2) is really irrelevant.

In *Wong Kam Wo* v. *Dulles*, 236 F.2d 622 (C.A.9, 1956), the court considered whether a law which conferred citizenship by birth on children of a citizen was a "naturalization" law within the meaning of the Hawaii Organic Act. The Government there pointed out that in two other statutes dealing with the subject of nationality the word "naturalization" was used in the sense of conferring citizen-

7. Section 105 corresponds to Section 632 of the 1954 Code (26 U.S.C. §632). There is no provision in the 1954 Code comparable to Section 114(b)(2).

ship on a person *after* birth. But the court refused to infer a similar restriction in the term as used in the statute at issue:

> "We are not persuaded that the use of an expressly restrictive statutory definition of 'naturalization' in the 1940 and 1952 enactments indicates that a similar, but unexpressed, restriction was intended in the 1900 [Hawaii Organic] act. . . . It would have been as easy in 1909 as it was forty years later to use express language in giving the term a narrow meaning, if such had been the intention." 236 F.2d at p. 625.

An argument like petitioners' was made by a taxpayer and rejected by this Court in *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84. The question there was whether interest on a tax refund was interest on an "interest-bearing obligation" within the meaning of Section 217(a) of the Revenue Act of 1926. The taxpayer pointed out that "obligations of the United States" as used in Section 213(b)(4) of the same act had been held to be limited to indebtedness incurred under the borrowing power of the Government, and argued that the narrow construction of "obligation" in the latter Section indicated a restrictive meaning in the former. The Court, however, analyzed the different purposes of the two provisions and concluded that "the intent of Congress . . . is fulfilled by giving the phrase a construction within the narrow purposes of §213(b)(4); and, in the other case, by a [broader] construction . . . which will effect the obviously different statutory aim of §217(a)." 293 U. S. at pp. 87-88.

As respondent shall presently show (*infra*, pp. 34-40), the construction of "discovery" in Section 456 adopted by the court below is in keeping with the purpose of that Section. Therefore, the fact that the word "discovery" is used in a narrower sense in other provisions with different

purposes, where a restrictive interpretation is expressly indicated, does not require the adoption of a narrow meaning in Section 456 where no limitation is stated or intended. Petitioners try to equate the terms used in the income and excess profits taxes by citing Section 728 of the World War II Act (Br. 55). They fail to state that Section 728 was not reenacted in the Korean War statute at issue here.

Moreover, other federal statutes and the Constitution use the term "discovery" where the word is obviously not limited to the discovery of mineral resources. For example, the Atomic Energy Act gives the Atomic Energy Commission power to make awards to "any person making an invention or discovery useful in the production or utilization of special nuclear material or atomic energy." Section 157(b)(3); 42 U.S.C. §2187(b)(3). See also United States Constitution, Article I, Section 8, Clause 8; Tennessee Valley Authority Act, Section 5(i) (16 U.S.C. §831(d)(4)); Mutual Security Act, Section 517(a)(1) (22 U.S.C. §1668(a)(1)); and Patent Code, Section 101 (35 U.S.C. §101).

On the other hand, when Congress was dealing with expenses attributable to the "discovery" of mineral resources it did not choose to describe these as expenditures for "discovery." In Section 23(ff) of the Internal Revenue Code of 1939, taxpayers were given the option to deduct expenses "paid or incurred during the taxable year for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral . . . prior to the beginning of the development stage of the mine or deposit." If the phrase "exploration, discovery, and prospecting" in Section 456(a)(2)(B) of the Internal Revenue Code of 1939 had the well-established limited meaning which petitioners claim, why did Congress not just use this phrase and grant a deduction in Section 23(ff) for expendi-

tures for exploration, discovery, or prospecting? In fact, Congress used none of these words but rather spelled out with particularity its intention to cover only those expenses relating to the uncovering of mineral resources.

2. *Noscitur a sociis is inapplicable.* A second argument advanced by petitioners is based on the old maxim of statutory construction *noscitur a sociis.* Since, it is said, the word "discovery" is associated with "exploration" and "prospecting," the term should be limited to the discovery of natural resources (Br. 6, 14-15). This was the principal reason for the limited scope given to Section 456(a)(2)(B) by the Court of Appeals for the First Circuit in the *Polaroid* case, No. 169 present Term. Starting with the assumption that since there are different types of discovery "some interpretation is called for," the court relied on the fact that the word was associated with terms sometimes identified with the mining industry. 278 F.2d at p. 151-152. A similar argument was rejected by this Court in *Russell Co.* v. *United States*, 261 U.S. 514. The question in that case was whether a statute empowering the President "to modify, suspend, cancel or requisition any existing or future contract" could be applied to a contract with the Government. The petitioner argued that the word "contract" which, standing by itself, might refer both to private and to governmental contracts, should be limited to the former, because "contract" was associated with the word "requisition." Petitioner

> "pointed out that the power to 'requisition' cannot apply to a governmental contract; and this may be conceded, since the Government cannot requisition what it already has. Then it is said that inasmuch as the application of the word 'requisition' must be confined to private contracts, the other words associated with it must be likewise restricted by virtue of the maxim *Noscitur a sociis.* That a word may be known

> by the company it keeps is, however, not an invariable rule, for the word may have a character of its own not to be submerged by its association." 261 U.S. at p. 519.

The Court then held the maxim inappropriate since it was "invoked not to remove an obscurity but to import one." *Id.* at 520. The statute was held to cover both private and governmental contracts, since such an interpretation "accords with the broad purposes of the legislation." *Id.* at 521. So in the present case discovery as ordinarily used refers both to mineral resources and to new drugs. To assume that only one meaning must be chosen by resort to the associated words is to "import" rather than to "remove an obscurity," since the statute can and should be applied to both sorts of discovery in appropriate cases in accordance with its basic purpose. Respondent concedes that Section 456(a)(2)(B) can be applied to the mining industry, but it does not follow that *only* the discovery of mineral deposits is within the statute. As this Court said in the *Russell* case, "the contention here is not that the power in question extends to private contracts but that it is limited to them. This cannot be conceded." *Id.* at 520.

The Government relied unsuccessfully on *noscitur a sociis* in *Wong Kam Wo* v. *Dulles*, 236 F.2d 622 (C.A.9, 1956). The question in that case, as we have noted, was whether a statute which conferred citizenship by birth was covered by the Hawaii Organic Act which applied to "naturalization under the laws of the United States," and provided that in certain instances "the requirement of a previous declaration of intention to become a citizen of the United States and to renounce former allegiance" was unnecessary. Since this requirement relates only to the obtaining of citizenship after birth, the Government argued that the word "naturalization" must be restricted accordingly. The court held, however, that:

> "While the application of this principle [*noscitur a sociis*] tends to support appellee's construction of the statute in question, we regard it as inconclusive. It seems unlikely that Congress would have depended upon the application of such a principle rather than express language, had it intended to restrict the established constitutional meaning of a word." 236 F.2d at p. 626.

In *Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, this Court refused to limit the meaning of a word by reason of associated words in a tax statute. The question in the case was whether interest on a tax refund paid to a foreign corporation was "income from sources within the United States," which was defined to include "interest on bonds, notes, or other interest-bearing obligations." The taxpayer argued that the word obligations "must be assimilated to the particular words 'notes and bonds,' and restricted to obligations of the same kind." 293 U.S. at p. 89. The Court held that to apply such a restriction because of the word association would be contrary to the purpose of the statute. "Plainly, the payment in question constitutes income derived from a source within the United States; and the natural aim of Congress would be to reach it." *Ibid.* So also in the present case the whole statutory provision must be considered as well as the immediately adjacent words. Respondent's income from Dramamine and Banthine would be shown at trial to constitute abnormal income attributable in part to prior years. The aim of Congress in Section 456 to give relief to such income would be frustrated by holding that "discovery" must be limited by the words "exploring" and "prospecting" in subparagraph (a)(2)(B).

Thus a word of broad and general meaning should not be given a restricted interpretation just because it is combined with words of more limited application. 2 Sutherland, Statutory Construction (3d ed.) §4908 at pp. 393-394. This

is particularly true here, for the history of Section 456 (a)(2)(B) indicates that association of "discovery" with "exploration" and "prospecting" is not of any significance. "Discovery" was associated with these two words *and* such other categories as research, development, patents, formulae and other processes, or any combination of them, in the 1940 predecessor statute. Specifically, the provision at issue in the present case was derived from Section 721(a)(2)(C) of the World War II Excess Profits Tax Law, which covered "income resulting from exploration, discovery, prospecting, research, or development of tangible property, patents, formulae, or processes." Thus the words "exploration" and "prospecting" were also in the former statute, but relief under Section 721(a)(2)(C) was not limited to mining operations. *E.g., W. B. Knight Machinery Co.*, 6 T.C. 519 (1946); *Rochester Button Co.*, 7 T.C. 529 (1946); *Keystone Brass Works*, 12 T.C. 618 (1949); *Ramsey Accessories Mfg. Corp.*, 10 T.C. 482 (1948). In modifying Section 721 in 1950, Congress did not provide that discovery relief was suddenly to be confined to natural resources. The same combination of "exploration, prospecting, and discovery" appeared even earlier in the Senate amendment to what ultimately became Section 327(d), the comparable relief provision of the Revenue Act of 1918. Although as finally enacted Section 327(d) referred generally to "abnormal conditions" which worked "an exceptional hardship" on the taxpayer, the history of the provision shows that Congress intended to include, as one instance of the abnormal conditions warranting relief, income derived from "prospecting or exploration and discovery work done by the taxpayer." See Internal Revenue Solicitor's Law Opinion 1090 (1922-I-1 Cum. Bull. 383, 386-388). A corporation which had spent large amounts "in experimental and discovery work" to develop a secret formula for the manufacture of a product, was held to qualify under Section 327. *Ibid.* Thus

"discovery" under the 1918 statute's relief for abnormal income was not restricted to oil, coal and gas, etc. Congress gave no indication when it used the very same combination of "exploration, discovery, and prospecting" in Section 456(a)(2)(B) that the associated words were henceforth to apply only to income from the discovery of mineral resources. Moreover, the wording of the statute is such that each word is given an independent significance. The language used is "exploration, discovery or prospecting *or* any combination of the foregoing." Petitioners' construction, on the other hand, would mean that discovery is covered *only* when in combination with exploration and prospecting in mining operations.

3. *The legislative history of Section 456 does not support petitioners' view.* Petitioners also seek support for limiting the scope of discovery in the legislative history of Section 456(a)(2)(B). Petitioners assert that Section 337 of the excess profits title of the Revenue Act of 1918, which was worded very much like Section 105 of the 1939 Code, *supra*, p. 16, was the ancestor of Section 456(a)(2)(B) (Br. 28). No explanation is suggested, however, for the absence of any reference to oil or gas in Section 456(a)(2)(B), such as appears in Section 337. The Committee reports and Congressional discussion of Section 456 do not indicate any connection between that provision and Section 337, much less do they show that Section 456(a)(2)(B) was just a new version of Section 337 "expanded to cover the gradual sale of the wasting asset" (Br. 28). It would be equally plausible to infer that in Section 456, Section 337 was "expanded to cover" the discovery of new drugs by the omission of the language about the sale of oil or gas property.

Section 456, however, did not stem from any "expansion" of Section 337. The two Sections work in entirely different ways. Section 337 placed an automatic 20% ceiling on the tax on the profit from sale. Under Section 456

income from discovery does not *per se* qualify for any relief; the income must also be shown to be abnormal and attributable to prior years, in which case the tax is recomputed accordingly. Section 456 appears rather to derive from Section 327(d), the provision giving relief in abnormal situations under the 1918 Excess Profits Tax. Although the term discovery was omitted in favor of more general language in the final version of Section 327(d), discovery income was intended to be included as one of the "abnormal conditions" qualifying for relief. Relief under Section 327(d) was not limited to the discovery of mineral resources. See, *supra*, p. 22.

Petitioners also rely on the elimination of the words "research and development" which were in Section 721 of the World War II Act (Br. 65-67, 73). The district court's summary judgment for petitioners was based on the idea that respondent's drug discoveries were "products arising out of research and development and as such specifically prohibited by Congress from being considered discoveries within the meaning of Section 456(a)(2)(B)" (R. 43-44).

The position taken by the district court was originally advanced by the Treasury Department in its proposed regulation on the subject, published in the Federal Register on December 4, 1952 (17 F.R. 10973). This proposed regulation stated:

> "Income from the sale of tangible property, however, even though such income may arise out of research and development which has extended over a period of more than 12 months is not income to which Section 456 is applicable. Such income from the sale of tangible property may not constitute or be included in any class of income for purposes of Section 456(b)."

This proposed regulation was abandoned after protests in favor of the one finally adopted which takes the oppo-

site position. The last sentence of the present regulation, which the Government has omitted from its quotation (Br. 18, note 16), states that "section 456 is applicable to such income [from research and development] if the income is properly includible within a class of income to which such section is applicable, for example, the class described in section 456(a)(2)(D)" (Treasury Regulations 130, Sec. 40.456-2(b), *supra*, pp. 3-4). The present regulation interprets the statute correctly.

The fact that the words research and development were eliminated from the statute does not mean that every form of income which can be encompassed by these words is thereby excluded from coverage. Congress nowhere stated that products "arising out of research and development" could not constitute discoveries, and the regulation as finally adopted so permits.

Respondent does not contend that income can qualify under Section 456 simply because it arises from research and development. But, as the regulation acknowledges, the elimination of these words was intended only to eliminate these broad terms, not to disqualify all income which happened also to be the product of research and development. The elimination of these words should not affect the meaning of discovery in Section 456. In *Gemsco, Inc.* v. *Walling*, 324 U.S. 244, this Court held that the Wage and Hour Administrator had power under the Fair Labor Standards Act to prohibit home work. Even though "the Senate bill contained * * * a parenthetical clause which expressly included homework among other specified practices the Administrator was authorized to restrict or prohibit, and this clause was omitted from the final conference draft" (324 U.S. at pp. 260-261), it was nonetheless held that the Administrator could prohibit homework when necessary to enforce the minimum wage provisions of the

statute. See also *United States* v. *Radio Corporation of America*, 358 U.S. 334; *Jefferson* v. *United States*, 178 F.2d 518 (C.A. 4, 1949), affirmed *sub nom. Feres* v. *United States*, 340 U.S. 135.

Research is a much wider concept than discovery. The contrast between research and invention or discovery was noted in *United States* v. *Dubilier Condenser Corporation*, 49 F.2d 306 (D.Del. 1931), affirmed, 59 F.2d 381 (C.A.3, 1932), affirmed, 289 U.S. 178, in which the court said:

> "While invention may and usually does presuppose research, research certainly does not usually involve or result in invention. To say that a person engaged in 'research' work is necessarily engaged in 'inventive work' is putting an unwarranted construction upon the word 'research' not justified by common knowledge or experience." (49 F.2d at p. 312.)

It is common knowledge that major companies have "research" departments which are constantly studying public opinion, introducing slight improvements in existing products, or experimenting with new processes. In fact it is arguable that most income of manufacturing corporations can in some way be attributed to "research and development." See, *e.g.*, *Crowell-Collier Publishing Co.*, 25 T.C. 1268 (1956); *L. E. Carpenter & Co.*, 29 T.C. 562 (1957). Therefore, inclusion of the words research and development threatened to create a major loophole in the administration of the tax. S. Rep. No. 2679, 81st Cong., 2d Sess. (1950) (1951-1 Cum. Bull. 240, 249). No such problem is presented by genuine discovery, which is a rare phenomenon. Even under Section 721 of the World War II Act, recoveries were modest, so that any "loophole" was at best potential (Govt. Br. 48; 67, note 58). Thus the Government's claim that millions of dollars in revenues would be jeopardized by the holding below is unwarranted (cf. Pet. 7).

Under the World War II Excess Profits Tax Law, income developed by "research" did not need to result from the discovery of a new product, but could qualify if the research involved only an improvement on an existing product or process. See, *e.g.*, *Keystone Brass Works*, 12 T.C. 618 (1949); *W. B. Knight Machinery Co.*, 6 T.C. 519 (1946). It proved administratively difficult in such cases to determine the extent and nature of any abnormal income from research since the claimed abnormal income had to be compared with income from similar previously existing products. Any increased income from an improvement might be attributable to increased demand for the basic product rather than to any improvement brought about by research. With a discovery these difficulties are eliminated. Income from the new product can be specifically identified and segregated and no previous similar income can be confused with sales of the new product. Thus the reasons for eliminating the classification of research and development do not exist with respect to a discovery.

The broad meaning commonly given to research and development which Congress sought to avoid by eliminating these words from the statute should not be reapplied in reverse by ruling, as did the district court, that *no* income in this wide category can come within the statute. Such a large exception is contrary to the Treasury Regulations, frustrates the intent of Congress and ignores the common distinction between research and discovery.

The history of a related provision of the World War II Excess Profits Tax Law reveals that if Congress had chosen to limit Section 456(a)(2)(B) to mining operations it would not have done so merely by eliminating the words research and development, etc. Section 711(b)(1)(I) of the World War II law governed the treatment of certain abnormal expenses in computing income during the base period. As

originally written, this Section closely paralleled the language of Section 721(a)(2)(C), *supra*, p. 22. The first version would have excluded "any deductions in connection with exploration, discovery, prospecting, research or development of tangible property, patents, formulae, processes or any combination of the foregoing." In conference it was decided to limit the exclusion to abnormal deductions in the base period for "costs paid or incurred in or for the drilling of wells or the preparation of wells for the production of oil or gas, and for development costs in the case of mines." 86 Cong. Rec. 12957-12958. In other words, when Congress wished to confine the special treatment of certain abnormal expenses to those incurred by taxpayers engaged in mining or in drilling for natural resources, it did not just confine the relief to deductions attributable to "exploration, discovery or prospecting," with the idea that these words related only to minerals. Rather the legislators made the intended limitation clear by express language. Yet petitioners would have us believe that Congress accomplished the same limitation with respect to abnormal income from discovery when it modified the same combination of words in an entirely different manner in Section 456(a)(2)(B).

Nothing in the committee reports or Congressional debates indicates that Section 456(a)(2)(B) was intended to be a special benefit only for the mining or oil and gas industry. It is true, as petitioners have pointed out, that certain references were made to mining in the Senate discussions of Section 721 in 1940 (Br. 52, note 50). But other taxpayers were also mentioned. In the same discussion on which petitioners rely it was also said of Section 721(a)(2)(C):

> "Protection is afforded under the relief provisions of the bill which permits promoters, developers, or

inventors to go back and apportion over several years what they have accumulated in earnings." 86 Cong. Rec. 12175. See also *id.* at p. 12176.

The quotations from the Joint and Senate Hearings on which the Government relies (Br. 51-52) do not appear to relate to Section 721. In any event, references to mining operations in Congressional debates, when considered in context, do not justify the conclusion that Section 456 was meant to apply only in that situation. See *Russell* v. *United States*, 261 U.S. 514, 522-523.

Neither the committee reports in 1940 relating to Section 721 nor the reports and Congressional debates in 1950 discussing Section 456 make any mention of the mining industry. The language used with regard to these provisions strongly negates the idea that they were for the special benefit of any one industry. Section 721 was introduced by the Senate in 1940. The Senate Report begins its description of the Section as follows:

> "The House bill contained a number of *special relief provisions*, generally in the form of adjustments in arriving at the excess profits net income. To these your committee has added further adjustments to take care of some *unusual cases of hardship*. . . .
>
> "*In addition*, your committee has provided a relief provision *of much wider and more general application*." S. Rep. No. 2114, 76th Cong., 3d Sess., 1940-2 Cum. Bull. pp. 528, 533.

This relief provision of "wider and more general" application, as distinguished from a "special" provision for an "unusual" case, was the predecessor to Section 456. Section 456 itself was viewed in the same light in the committee reports on the 1950 Act. The provisions of the Korean

War statute were discussed *seriatim* under several general headings in both the House and Senate reports. Section 456 was discussed as part of group III "MAJOR PROVISIONS OF GENERAL APPLICATION." H. Rep. No. 3142, 81st Cong., 2d Sess., 1951-1 Cum. Bull. pp. 188-204 (Section 456 is discussed at page 195); S. Rep. No. 2679, 81st Cong. 2d Sess., 1951-1 Cum. Bull. pp. 241-259 (Section 456 is covered at p. 249). As we have noted, no mention is made in either report of oil, gas or any other minerals in connection with Section 456, much less is there any hint that this "major provision of general application" was intended to benefit only that one industry.

There were special provisions for limited groups of taxpayers in the Korean War statute. In the Committee reports these Sections were treated separately under item IV, "OTHER IMPORTANT PROVISIONS." (House Report pp. 204-208. Senate Report, pp. 259-267.) Included under this heading were Sections relating to regulated utilities, foreign corporations, personal service companies, and so forth. Special provisions for taxpayers engaged in mining were discussed together (House Report p. 205; Senate Report, pp. 261-262). These particular benefits included the exemption of income from mining specified "strategic minerals," the exemption of income attributable to excess output of mining and timber operations and from natural gas properties, and the exclusion of subsidies paid by the Government to encourage mining of critical minerals. If Congress had looked upon Section 456(a)(2)(B) as being in the same category of special benefits for taxpayers in the oil, gas and mining industry, the Committee Reports would have included it in this discussion rather than under the heading of major provisions of general application. The special relief provisions for natural resources in the World War II Act were also discussed separately in the Commit-

tee Reports of 1941 and 1942, cited by petitioners, and were not in any way "coordinated with" Section 721(a)(2)(C), as petitioners assert (Br. 54).

Another instance where Congress made its meaning explicit when it wished to give special relief to a particular industry was in a provision permitting a carryover of unused excess-profits tax credit for taxpayers, "80 per cent or more of whose gross income is derived from processing, canning, or otherwise preparing for market any seasonal fruit or vegetable or any fish or other marine life." Both the language of the proposed Section 721(b) and the Senate Committee's discussion made it clear that the carryover was "available only to corporations" so particularly described. S. Rep. No. 2114, 76th Cong., 3d Sess. (1940-2 Cum. Bull. pp. 533, 540.) On the floor of the Senate this provision was expanded to include taxpayers 80% of whose income came "from mining or processing minerals." 86 Cong. Rec. 12181. The entire subsection was later eliminated in conference. 86 Cong. Rec. 12959. The brief history of this proposal adds further evidence that if Congress had wished to limit relief under the abnormal income provisions to certain taxpayers it would have so stated in the statute itself and in its legislative history.

4. *The reference to patents in Section 456(a)(2)(C) does not preclude recovery here under Section 456(a)(2)(B).* Another line of reasoning used by the court of appeals in the *Polaroid* case but only briefly mentioned by petitioners (Br. 16-17) is based on Section 456(a)(2)(C), which lists "income from the sale of patents, formulae, or processes" as one of the classes of abnormal income. The First Circuit thought that discovery must not be interpreted to cover patentable discoveries lest it overlap subparagraph (C). (278 F.2d at p. 153.) This assumes that the categories listed in the four subparagraphs of Section 456 were meant to be mutually exclusive. But the draftsmen of the statute

understood that income might be "classifiable in more than one of such subparagraphs," in which case they provided that such income "shall be classified under the one which the taxpayer irrevocably elects." *Supra*, p. 3. Therefore the fact that income from discovery might in certain instances also be classified as income from the sale of a patent presents no obstacle to giving discovery its normal meaning.

The relief expressly accorded to the sale of a patent was not intended to exclude income from the exploitation of a discovery by a taxpayer which uses its own discovery.[8] The First Circuit's metaphor about holes in fences for various size cats is a restatement of the venerable maxim *expressio unius est exclusio alterius*, a rule of construction which this Court has frequently refused to apply. See *United States* v. *Barnes*, 222 U.S. 513; *Springer* v. *Philippine Islands*, 277 U.S. 189; *Neuberger* v. *Commissioner*, 311 U.S. 83. In *Securities and Exchange Commission* v. *C. M. Joiner Corp.*, 320 U.S. 344, this Court held that under all the circumstances of the case before it, the sale of certain oil leases fell within the scope of the Securities Act of 1933. The respondent argued that its sales could not be covered because they were of mineral rights on particular parcels of land:

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8. The court in the *Polaroid* case expressed concern that periodic income from patent royalties might be given relief under a broad construction of subparagraph (B), whereas the provision in subparagraph (C) for the sale of patents was thought to imply an exclusion of such income. 278 F.2d at p. 153. But special treatment for the sale of patents under income tax laws applies even though the seller's remuneration is payable periodically over a long term or is contingent on future productivity under the patent. See 26 U.S.C. §1235(a); *Commissioner* v. *Hopkinson*, 126 F.2d 406 (C.A. 2, 1942). Congress did not, therefore, by providing in subparagraph (C) for the "sale" of patents mean to confine relief to the case where a single lump sum payment is made in one year. Petitioners even concede this (Br. 11, note 10).

> "It is urged that because the definition mentions 'fractional undivided interest in oil, gas or other mineral rights' it excludes sales of leasehold subdivisions by parcels." (320 U.S. at p. 352.)

The Court held, however, that by using this specific phrase the draftsmen had not "thereby immunized other forms of contracts and offerings which are proved *as matter of fact* to answer to such descriptive terms as 'investment contracts' and 'securities.'" 320 U.S. at p. 352. The Court said that rules of construction such as *expressio unius est exclusio alterius* "have long been subordinated to the doctrine that courts will construe the details of an act in conformity with its dominating general purpose." *Id.* at p. 350. The purpose of the Securities Act was held to require regulation of the sale of all devices "if it proved *as matter of fact* that they were widely offered or dealt in under terms or courses of dealing which established their character in commerce as 'investment contracts.'" *Id.* at p. 351. In the present case, respondent should not be foreclosed by summary judgment from proving as a matter of fact that its income from Dramamine and Banthine arose under circumstances which qualified it as "discovery" income within the meaning and purpose of Section 456. See *infra*, pp. 34-40.

In *Bland* v. *Commissioner*, 102 F. 2d 157 (C. A. 7, 1939), certiorari denied, 308 U.S. 563, the salary of a judge appointed to the United States Court of Customs Appeals in 1923 was held to be taxable as income from "salaries" under Section 22(a) of the Revenue Act of 1932, even though the same Section also expressly provided that "in the case of . . . judges of courts of the United States taking office after June 6, 1932, the compensation received as such shall be included in gross income." By the same reasoning, respondent's income from "discovery" should

not be barred from relief under Section 456 because this income was not derived from the "sale of a patent."

Use of the *expressio unius* rule by the First Circuit in interpreting Section 456 ignores the manner in which the provision is meant to operate. The fundamental purpose of Section 456 is not to give automatic relief to the listed categories of income as such. Income falling within one of the listed categories is not qualified for special treatment unless it is proved to be abnormal in kind or amount for the particular taxpayer in the taxable year and can be proved to be attributable to prior years. Pursuant to the last sentence of Section 456(a)(2), income not in one of the specifically named classes of subparagraphs (A) through (D) can still qualify for relief subject to regulations if it meets the other tests of the statute. The specific categories listed in (A)-(D) are designed to classify income for the purpose of determining abnormality under Section 456(a)(1) rather than to grant or confine relief to the items listed. A taxpayer whose principal business is the discovery and sale of new products could not ordinarily qualify under subparagraph (B) since his income though from discovery would not be abnormal under Section 456(a)(1). But if in a particular year he sold one of his patents, the profit from such sale considered separately under subparagraph (C) might meet the abnormality tests of Section 456(a)(1). On the other hand a taxpayer who normally sells commonly marketed products might earn abnormal income from a new, original discovery which was the product of several prior years' effort. This is essentially what respondent did, as can be proved at trial.

III. THE PURPOSE OF SECTION 456 IS FULFILLED BY THE DECISION OF THE COURT BELOW.

Respondent does not rely solely on the ordinary meaning of the word discovery and on the absence of any express

limitation in the statute or its legislative history, which might indicate that relief was confined to taxpayers in the oil and gas industry. Respondent's claim is also supported by a consideration of the purpose of the Korean War Excess Profits Tax Act as a whole and of Section 456 in particular. The main objective of the excess profits tax was to tax profits attributable to the large military budget and a profitable wartime economy. As the House Report stated:

> "One of the main objectives in imposing an excess profits tax is to reach corporate profits which have been swollen by the increased tempo of the economy. An excess profits tax selects for additional tax those corporations whose profits are higher than they probably would have been in the absence of hostilities and a large military budget." H. Rep. No. 3142, 81st Cong., 2d Sess. (1950) (1951-1 Cum. Bull. at p. 187). See also S. Rep. No. 2679, *id.*, at p. 241.

In providing relief in exceptional situations such as those covered by Section 456, Congress recognized that in some instances high profits would not be attributable to military spending or to generally higher wartime economy. Section 456, like its predecessor in World War II, was designed to take this into account:

> "Congress anticipated that business for many taxpayers would improve because of external changes and it intended the tax to apply in those cases. It also realized that there might be some instances in which the income of the base period years might not satisfactorily reflect internal changes in the business. That is, there might be cases in which the increase in profits of the tax year over those of the base years might be attributed, at least in part, to internal changes and development of a particular business or some phase of that business to its full stature and to that extent would not be attributable to the outside business stimulus." *Soabar Company*, 7 T.C. 89, 96 (1946).

Unless Searle's discoveries fall under Section 456(a)(2), the coincidence that the discovery of Dramamine and Banthine occurred shortly before the outbreak of the Korean War would operate to penalize respondent in a way which Congress did not intend. These drugs had nothing to do with the war nor were their sales attributable to the war-time economy. Respondent's discoveries, because they were new and useful advances in medicine, would have resulted in abnormal income to their discoverer in peace-time as well. This income was the result of "internal changes and development of a particular business" (7 T.C. at p. 96); it was not a case of income "swollen by the increased tempo of the economy" as a whole (1951-1 Cum. Bull. at p. 187).

Moreover, the discovery of these drugs resulted from years of effort and expense which were brought to fruition during the excess profits tax period. The competitive advantage of a new drug discovery lasts only a short time. Recognizing the unfairness of bunching for heavy taxation in one year income which is in fact attributable to several years, Congress intended that such abnormal income if it can be shown to be attributable to other years, should be taxed accordingly. All respondent seeks is an opportunity to prove that this income was in fact attributable to other years and is therefore entitled to relief.

Finally, by including the word "discovery" in Section 456 (a)(2)(B), Congress intended to modify an excessive tax burden which would impair incentive to discover new products for industrial progress. Surely the desire to encourage invention is no less when medical science is advanced by the discovery of new drugs.

Petitioners do not appear to dispute the fact that the granting of relief with respect to respondent's drug discoveries would be in accordance with the general purpose of Section 456. But, while conceding that respondent's

claim may be meritorious, petitioners suggest as a countervailing consideration that the Korean War Act and Section 456 in particular were designed to replace the "discretionary" and "subjective" relief provisions of the prior law with provisions permitting a "mathematical or 'automatic' relief formula." (Br. 11.) Respondent does not consider that any of the subparagraphs (A) to (D) permit such a formula. Such objective computation is said to be possible only if discovery is limited to natural resources where income attributable to discovery can be "mathematically computed" on the basis of the "discovery value" of mines. (Br. 12). If Congress had had this alleged distinction between the discovery of mines and the discovery of new products in mind, some mention of it would appear in the discussion of Section 456 in the Committee Reports, but it does not.

In any event, the distinction is highly questionable. It is often hard to decide whether or not a particular mine or well constitutes a discovery. In considering whether a coal mine was a "discovery" within the meaning of the predecessor of Section 114(b)(2) of the 1939 Code, the Board of Tax Appeals said that "no arbitrary rule as to what will constitute a sufficient discovery can be stated which will govern in all cases. * * * And hence whether a discovery has been made is a question of fact . . ." *Clarence D. Robinson*, 8 B.T.A. 778, 782-83 (1927). In *Smith* v. *United States*, 52-2 CCH U.S. Tax Cases ¶ 9402 (S.D. Iowa), the District Court had to resolve a conflict in expert testimony as to whether or not plaintiffs' limestone quarry was a "discovery." See also *Arrel* v. *Gentsch*, 52 F.Supp. 635 (N.D. Ohio, 1943).

Even if a mineral deposit is classified as a discovery, complicated factual issues requiring exercise of subjective judgment are raised by the determination of "discovery value." In *R. L. Wheelock*, 28 B.T.A. 611 (1933), the Board of Tax Appeals had to choose among estimates ranging

between $184,000 and $425,000 in guessing the discovery value of an oil lease. In *H. A. Allen*, 7 B.T.A. 1256, 1273-74 (1927), the evidence as to value varied from $750,000 to $2,000,000. Depletion based on discovery value was ultimately limited to mines because of the "very difficult" administrative problem of determining the discovery value of oil and gas wells. See S. Rep. No. 52, 69th Cong., 1st Sess., 1939-1 Cum. Bull. (Part 2) pp. 332, 345; H. Conference Rep. No. 356, *id.*, at p. 362. Further problems are raised by the 12-month period in Section 456(a)(2)(B), which requires a determination of when "discovery" ends and "exploitation" begins. Revenue Ruling 236 (1953-2 Cum. Bull. 236) states that one must carefully distinguish between "that development" of oil and gas property which "is the equivalent of 'exploration' and 'discovery'" and "that 'development'" which "is the equivalent of 'exploitation,'" since the latter "development" does not come under the statute. Such a hair-splitting distinction does not lend itself to strict objective application, nor does the Ruling "suggest any criteria for determining" how to differentiate these types of development. Cf. Govt. Br. 17. Moreover, Revenue Ruling 236 does not support petitioners' contention that Section 456(a)(2)(B) applies only to natural resources. The heading of this ruling shows that it covers the "Application of Section 456 of the Internal Revenue Code to the oil and gas extractive industry." The ruling in no way indicates that Section 456 was intended to apply *only* to the oil and gas extractive industry. In fact, the heading itself implies that the Section also applies to other industries. Obviously this 1953 ruling does not discuss other industries where discovery occurs unaccompanied by exploration or prospecting, and the Treasury has subsequently granted relief to a drug under Section 456(a)(2)(B) by settling a claim thereunder involving an antibiotic of one of Searle's competitors.

Even with the unwritten limitation on "discovery" which petitioners seek to read into the statute, Section 456 (a)(2)(B) does not permit an "objective computation" or the "automatic application" of mathematical formulas. On the other hand, the administrative problems presented by applying the statute to discoveries in the ordinary sense of the word do not appear difficult. In the *Polaroid* case the taxpayer and the Government were able to stipulate the amount of the tax-saving involved under the taxpayer's claim. See 278 F.2d at p. 150. In the present case, respondent will have the burden of proving at trial what portion of its income was attributable to the discovery of Dramamine and Banthine. The Government, without allowing respondent to present its evidence, asks this Court to assume that segregating respondent's abnormal income will be virtually impossible. Such an argument seems a singularly inappropriate reason for summary judgment.

Admittedly if Section 456(a)(2)(B) is only for taxpayers engaged in the business of searching for mineral deposits, respondent would not qualify under that provision. But summary judgment should not be granted when it requires the decision of an important novel question of law with an inadequate factual background. *Eccles* v. *People's Bank*, 333 U.S. 426; *Arenas* v. *United States*, 322 U.S. 419; *Kennedy* v. *Silas Mason Co.*, 334 U.S. 249. The present case for the first time raises the question of the meaning of the word "discovery" in Section 456(a)(2)(B).[9] The decision of the court of appeals, which would allow respondent to prove at trial that it had earned abnormal income attributable to prior years resulting from a discovery rather than from the increased tempo of war-time economy, is fully in accord with the purpose of Section 456.

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9. *Specialties, Inc.* v. *United States*, 174 F. Supp. 89 (E.D.N.Y., 1959) did not involve Section 456(a)(2)(B) or the last sentence of Section 456(a)(2) and is not contrary to respondent's view (cf. Govt. Br. 15, note 14; 66, note 57).

Petitioners assert that respondent's construction of the statute would require courts to make an unduly difficult distinction between "real inventions" and "mere improvements" (Br. 17; see also 278 F.2d at p. 152). But such a distinction is no more nebulous than that necessary under Section 443 which requires a "substantial" change in a taxpayer's products as opposed to a "mere improvement or change in style." Treas. Reg. 130, Sec. 40.443-2. Section 435(e) also involves drawing a line between a new product and "a modification of an old product" or "improvement". Treas. Reg. 130, Sec. 40-435-3(e).

Petitioner's suggestion that respondent should look to Sections 443, 444 and 435(e) for relief rather than to Section 456 is unwarranted (Br. 65). Those Sections were designed to cover different situations. None of them accords relief to a taxpayer who earns abnormal income in one year which resulted from effort and expense in prior years to which part of the income should be attributed. One could just as plausibly argue that taxpayers engaged in mining are not under Section 456(a)(2)(B) because Congress contemplated they would look to such Sections as 450 and 453 for relief instead!

IV. IN THE ALTERNATIVE, RESPONDENT'S INCOME FROM DRAMAMINE AND BANTHINE CONSTITUTED A SPECIAL CLASS OF ABNORMAL INCOME UNDER SECTION 456(a)(2) OF THE EXCESS PROFITS TAX ACT OF 1950.

Even should this Court hold that the term "discovery" in Section 456(a)(2)(B) does not encompass the discovery of Dramamine and Banthine, respondent would still be entitled to relief. The income from these drugs constitutes a separate class of income in respondent's business which can be shown to meet the abnormality test of Section 456(a)(1) for the taxable years in question.[10] The last sentence of Section 456(a)(2) makes it clear that income does

10. This alternative contention was presented to but not passed on by the court of appeals (R. 53). Since this issue may be reached by this Court in the *Polaroid* case, respondent has covered it here.

not have to qualify under subparagraphs (A) through (D) to be treated as abnormal. It provides:

> "The classification of income from any class not described in subparagraphs (A) to (D), inclusive, shall be subject to regulations prescribed by the Secretary."

The applicable regulation under this sentence, Treasury Regulations 130, Section 40.456-2(b), provides as follows:

> "Other income, not within a class described in subparagraphs (A)-(D) of Section 456(a)(2), to which section 456 is applicable may be grouped by the taxpayer, subject to approval by the Commissioner on the examination of the taxpayer's return, in such classes similar to those specified in subparagraphs (A)-(D) of Section 456(a)(2) as are reasonable in a business of the type which the taxpayer conducts, and as are appropriate in the light of the taxpayer's business experience and accounting practice. * * *"

Thus income not described by subparagraphs (A) through (D) may be grouped in classes for measuring abnormality provided that the classification is *reasonable* and *appropriate* in view of taxpayer's business and accounting experience. Respondent's income from Dramamine and Banthine was sufficiently unlike its income from other sources that this separate classification was reasonable and appropriate. Respondent expects to show at trial that its income from Dramamine and Banthine can properly be classified separately from its income from other products. These drugs were completely new in concept and successfully performed functions not previously performed by earlier pharmaceutical products. None of the other drugs marketed by Searle was a new discovery. Whereas the Government rejected Searle's claim for refund of World War II excess profits taxes because Searle had at that time no new products (R. 29-38), the examining officer in the present case concluded that Dramamine was a new discovery (R. 29). Respondent would also show that its income from these two drugs was abnormal in amount in the taxable years within the requirements of Section 456(a)

(1), and was attributable to prior years under Section 456 (b).

This Court need not decide whether respondent's proposed evidence would sustain its assertion of the distinctiveness of Dramamine and Banthine and justify the reasonableness and appropriateness of the separate classification of the income from these drugs; these are genuine issues of material fact which preclude the granting of summary judgment. The district court did not consider whether respondent's classification was reasonable or appropriate because it erroneously held that Searle's income could not qualify since it resulted from research. Therefore the reasonableness and appropriateness of respondent's classification have not yet been argued or considered, nor can they be until all relevant facts are brought forth at trial. Summary judgment on this issue of fact was improper.

Although the court of appeals in the present case found it unnecessary to consider respondent's alternative ground for relief (R. 53), the First Circuit in the *Polaroid* case rejected the taxpayer's comparable claim under the last sentence of Section 456(a)(2). The court held that the Commissioner had discretion to accept or deny unlisted classifications. Since Treasury Regulations 130, §40.456-2 (b) makes classification "subject to approval," failure to obtain such approval was held fatal to the taxpayer's cas This interpretation of the Commissioner's role under Section 456(a)(2) is squarely opposed to the Government's claim, also accepted by the First Circuit, that Congress wished to avoid "the introduction of a large degree of administrative discretion" in Section 456. 278 F.2d at p. 454. Petitioners argue that "discovery" must be given a special meaning in order to limit administrative discretion, yet at the same time they say the Commissioner's discretion in passing on taxpayers' classifications under Section 456 (a)(2) is unlimited! Petitioners assert that the last sentence of Section 456 (a)(2) "merely grants the Secretary

authority to designate such additional classes of abnormal income as he may consider appropriate" (Br. 68). However, this cannot be true because the Secretary has never designated any such additional classes but rather has promulgated the regulation setting forth rules whereby the taxpayer may designate special classes of income, if reasonable and appropriate. Since the taxpayer's classifications must be reasonable and appropriate to qualify, the petitioners' assertion that under respondent's view "income of any class must be considered 'abnormal' if it meets the quantitative test" (Br. 68) is unjustified.

The First Circuit also held that the only allowable classes under Section 456(a)(2) are those which are "similar" to the ones specified in subparagraphs (A) through (D). This qualification appears in the regulation but not in the statute. If "similar" is construed to mean that a class must be virtually identical to one of those specified in (A) through (D), the last sentence of Section 456(a)(2) would be rendered meaningless. On the other hand, if a taxpayer classifies separately a readily identifiable segment of income, outside the scope of his other operations and attributable to prior years, such a class would be "similar" to the classes specified and accordingly should qualify for relief provided the other tests of the statute and regulations are satisfied.

It is true that income from research and development may not constitute a class of abnormal income as such. Respondent, however, did not place its income from Dramamine and Banthine in the category of income from research and development. In fact while all respondent's products entailed some research, Dramamine and Banthine are unique among respondent's drugs in that they are new discoveries. The very basis of respondent's claim is that these drugs were different from its ordinary products of research. The fact that these discoveries involved some

prior research does not bar them from relief, as the last sentence of Treasury Regulation 130, Section 40.456-2(b) makes clear. See *supra*, p. 4.

The Government's assertion that the last sentence of this regulation means only that income is not excluded if it qualifies "under a class *listed* in Section 456(a)(2)" is erroneous (Br. 69). The sentence applies to any class of income to which the principle of Section 456 "is applicable", whether or not the class is one of those listed in subparagraphs (A)-(D).

CONCLUSION

The district court's holding that all income attributable to research is *ipso facto* excluded under Section 456 was erroneous. Therefore, the judgment of the court of appeals should be affirmed and respondent should be given an opportunity to prove that Dramamine and Banthine were discoveries within the meaning of Section 456(a)(2)(B), or, in the alternative, that the income from these drugs was abnormal under the last sentence of Section 456(a)(2).

Respectfully submitted,

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